

Before the
Illinois Commerce Commission

In the Matter of

Approval of an Increase and
Adjustment of Rates and Charges for
Water Utility Service Sold by
Apple Canyon Utility Company within
Jo Daviess County

Direct Testimony of

Amanda M. Ross
Senior Regulatory Accountant

for

Apple Canyon Utility Company

April 30, 2003

ILLINOIS COMMERCE COMMISSION
MAY 11 2003
ST. LOUIS, MO 63102

1 **9. Please state your name and business address.**

2 A. My name is Amanda M. Ross. My business address is 2335 Sanders Road,
3 Northbrook, Illinois 60062.

4
5 **9. What is your occupation?**

6 A. I am the Senior Accountant for the Regulatory Department of Utilities, Inc. and its
7 subsidiaries.

8
9 **9. Please summarize your professional background?**

10 A. I have been employed by Utilities, Inc. since April of 2002. Since that time I have
11 been involved in many phases of rate-making in several regulatory jurisdictions. I
12 graduated from Purdue University in 2000, and I am a Certified Public Accountant.
13 I had two years of public accounting/financial analysis experience prior to joining
14 Utilities, Inc., and I am a member of the American Institute of Certified Public
15 Accountants.

16
17 **9. Please explain your job responsibilities with Utilities, Inc.?**

18 A. My responsibilities include: financial analysis of individual subsidiaries of Utilities,
19 Inc., preparation of applications for rate relief, facilitation of commission audits,
20 and the submission of financial testimony and schedules to support a request for
21 an increase in rates.

22
23 **Background**

24
25 **9. Please describe Apple Canyon Utility Company.**

26 A. Apple Canyon Utility Company is a wholly owned subsidiary of Utilities, Inc. (UI).
27 Water Service Corporation (WSC) manages the operation for all of UI's water and
28 wastewater systems, including Apple Canyon. WSC provides management,
29 administration, engineering, accounting, billing, data processing, and regulatory
30 services for the utility systems. WSC's expenses are assigned directly to a utility or
31 distributed to the various companies pursuant to a formula that has been approved
32 by the Commission.

1 Apple Canyon provides water usage service to approximately 735 customers and
2 water availability service to approximately 1,951 customers in Lake County. Apple
3 Canyon's current rate structure was approved pursuant to Order No. 92-0401
4 dated August 4, 1993.

5
6 **Q. Ms. Ross, what is the purpose of your testimony here today?**

7 A. The purpose of my testimony is to explain to the Commission why Apple Canyon
8 Utility Company has requested an increase in water rates. I will also discuss some
9 of the factors that have contributed to the need for the increase and the impact of
10 the increase on our customers. I will present and describe schedules showing the
11 overall cost of capital and proper rate of return on rate base, and I will also sponsor
12 the Utility's financial exhibits.

13
14 In addition, I will provide information to support Apple Canyon Utility Company's
15 request to change depreciation rates from composite rates to class-of-asset rates, to
16 convert the current quarterly billing cycle to a monthly billing cycle, and to update
17 the Rules, Regulations, and Conditions of Service tariffs.

18
19 **Rate Relief**

20
21 **Q. Why is Apple Canyon Utility Company requesting rate relief at this time?**

22 A. A rate increase is necessary to allow the Utility to recover the reasonable and
23 prudent costs of providing service and an opportunity to earn a fair and reasonable
24 rate of return on its invested capital. Rates granted in 1993 do not reflect the 10
25 years of rising costs, many of which result from stringent federal environmental
26 regulations, increased investment, and inflation. For these reasons the Utility is
27 not able to achieve a reasonable rate of return on its investment. Rate relief is
28 essential to ensure the continued availability of capital at a reasonable cost and to
29 maintain a high and professional level of service. Under the present rate schedule,
30 Apple Canyon is not earning a fair and reasonable return on its investment. After
31 making pro forma adjustments to the December 2002 test year for known, fixed
32 and measurable changes Apple Canyon Utility Company has an overall return of
33 2.12%. The proposed rates will allow the company to earn a 9.39% overall rate of
34 return. This information is supported in the financial statements attached hereto
35 as **Utility Exhibit One.**

1 **Q. Ms. Ross, what factors, or changes in the cost of service, can you point to**
2 **that have contributed to the need for the requested increase?**

3 A. The age of the system is a factor in the cost of maintenance to be done. As the
4 system ages, the cost of maintenance increases. In addition, Apple Canyon has
5 spent a considerable amount of time and money to replace one of the wells to
6 ensure customer satisfaction and water delivery. Apple Canyon Utility Company is
7 committed to maintaining clean, safe, professional facilities. Our facilities are
8 visible throughout the communities we serve.

9

10 **Rate Analysis**

11 **Q. What are the present water rates for Apple Canyon Utility Company and when**
12 **did they become effective?**

13 A. The present usage and availability rates became effective on August 4, 1993, and
14 are as follows:

15 Base Facility Charges:

16 Residential:

17 5/8" Meter \$15.00

18 Commercial:

19 5/8" Meter \$15.00

20 1" Meter \$18.00

21 1.5" Meter \$19.50

22 2" Meter \$21.00

23 3" Meter \$22.50

24 Gallonge Charges: \$4.23 per 1,000 gallons

25 Availability Charges: \$15.00

26

27 It should be noted that these rates are billed quarterly. The current quarterly
28 average consumption for residential customers in Apple Canyon is approximately
29 6,632. This equates to a quarterly bill of \$43.05.

30

31

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34

1 **Q. What are the proposed water rates for Apple Canyon Utility Company and**
2 **their impact on the average customer?**

3 A. The proposed rates are as follows:

4 Base Facility Charges:

5 Residential:

6 5/8" Meter \$13.50

7 Commercial:

8 5/8" Meter \$13.50

9 1" Meter \$17.50

10 1.5" Meter \$19.00

11 2" Meter \$20.00

12 3" Meter \$22.00

13 Gallage Charges: \$5.00 per 1,000 gallons

14 Availability Charges: \$7.15

15

16 These rates will be billed monthly pending the Commission's approval of the
17 Company's request to convert the current quarterly billing cycle to a monthly
18 billing cycle. Based on an average consumption of 2,211 gallons per month, the
19 customers' monthly bill will be \$24.55 or an increase of \$10.20 per month.

20

21 **Cost of Capital**

22

23 **Q. What is the cost of capital of Apple Canyon Water Company?**

24 A. The cost of capital of Apple Canyon Utility Company is determined by using UI's
25 capital structure. These cost of capital percentages are then used to ascertain the
26 overall cost of capital for Apple Canyon Utility Company. The capital structure and
27 cost rates that I proposed to use in this proceeding are as follows:

28

	<u>Weight</u>	<u>Cost</u>	<u>Weighted Cost</u>
Debt	45.69%	8.64%	3.95%
Equity	<u>54.31%</u>	<u>10.02%</u>	<u>5.44%</u>
Overall	<u>100.0%</u>		<u>9.39%</u>

29

30

31

- 1 **Q. Why must one determine the overall cost of capital for a public utility?**
- 2 A. The proper balance of rate payer and shareholder interest occurs when the
- 3 Commission authorizes a public utility a rate of return on its rate base equal to its
- 4 overall cost of capital. If the authorized rate of return on rate base exceeds the
- 5 overall cost of capital, then rate payers bear the burden of excessive prices.
- 6 Conversely, if the authorized rate of return on rate base is lower than the overall
- 7 cost of capital, then the Utility will be unable to raise capital at a reasonable cost.
- 8 Ultimately, the Utility may be unable to raise sufficient capital to meet demands for
- 9 service, thereby impairing service quality. Therefore, ratepayers interest are served
- 10 best when the authorized rate of return on rate base is neither higher nor lower
- 11 that the overall cost of capital.
- 12
- 13 **Q. Please define "overall cost of capital"?**
- 14 A. The overall cost of capital equals the sum of the costs of the components of the
- 15 capital structure (debt and common equity) after each is weighted by its proportion
- 16 to total capital.
- 17
- 18 **Q. How does Apple Canyon raise capital?**
- 19 A. Capital for Apple Canyon is raised by Utilities, Inc. Apple Canyon Utility Company
- 20 is a wholly owned subsidiary of Utilities, Inc. The source of this capital is banks
- 21 and large lending institutions
- 22
- 23 **Q. How did you determine the cost of debt to Apple Canyon?**
- 24 A. The 8.64% cost of debt is the embedded cost of debt of the Utilities, Inc., the parent
- 25 company of Apple Canyon, as of December 31, 2002. This percentage is consistent
- 26 with past Illinois Commerce Commission practice.
- 27
- 28 **Q. How did you derive the cost of equity used in your calculation?**
- 29 A. Today's embedded cost of debt of the consolidated group is approximately 8.64%.
- 30 The equity investor is entitled to a premium over the return to the debt holder
- 31 because of the additional risk he or she takes. The debt holder has first claim on
- 32 the assets and earnings of the Utility. These claims must be satisfied before funds
- 33 are available to the equity shareholder. Therefore, the return on equity must be
- 34 greater than 8.64%.
- 35

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1 In addition, a risk free investment, thirty-year treasury bonds, currently yields
2 approximately 4.94%, as of April 15, 2003. Utility bonds available to investors are
3 a higher risk than government bonds. Also available to investors are equity
4 securities of large companies. These are publicly traded securities paying
5 dividends and having the advantage of liquidity. Naturally, the market would favor
6 any of these securities over the equity in a small company with non-traded
7 securities, such as Apple Canyon. It would be reasonable to add a premium to the
8 cost of 30-year treasury bonds to determine the cost of equity to Apple Canyon.

9
10 In addition, in the last rate proceeding (Docket #02-0592), Staff witness Rochelle
11 Phipps opined that 10.02% is a reasonable cost of equity for one of UT's operating
12 subsidiaries. In view of the proceeding information, I believe that 10.02% is the
13 minimum cost of equity and that an overall return of 9.39% is reasonable.

14
15 **Depreciation**

16
17 **Q. What is the current method of calculating depreciation expense at Apple**
18 **Canyon Utility Company?**

19 A. Currently, Apple Canyon Utility Company multiplies all plant-in-service accounts
20 by a composite rate of 1.50% to calculate annual depreciation expense.

21
22 **Q. What method of calculating depreciation expense is the Utility proposing?**

23 A. The Utility is proposing a change from using a composite rate of 1.50% to utilizing
24 separate depreciation rates for each primary account. These rates range from
25 1.89% to 7.69%. This method of calculating depreciation expense is consistent
26 with prior rate proceedings approved by the Commission, including Docket No. 01-
27 0663, Lake Wildwood Water Company, and Docket No. 02-0592, Del-Mar Water
28 Company.

29
30 **Q. Why is Apple Canyon Utility Company proposing this change in depreciation**
31 **rates in order to calculate depreciation expense in this rate proceeding?**

32 A. The Utility has proposed these modified depreciation rates based on testimony filed
33 by Staff witness King in Docket Nos. 01-0663 and 02-0592. According to this
34 testimony, separate depreciation rates for primary accounts are more sensitive to
35 the service life and retirement in a specific account than a composite rate. As

1 such, rates by primary accounts result in a more accurate allocation and recovery
2 of depreciation expense. Therefore, the Utility's calculation of depreciation expense
3 was prepared using the average service lives, salvage values, and calculations
4 utilized in ICC Staff Exhibit 6.00, Schedules 6.01 and 6.02 of Docket No. 01-0663
5 and ICC Staff Exhibit 4.00, Schedule 4.04, pages 1 and 2 of Docket No. 02-0592.

6
7 **Q. How do the depreciation rates proposed by the Utility compare to the rates**
8 **approved by the Commission in prior rate proceedings?**

9 A. The depreciation rates proposed by the Utility are consistent with the average
10 service lives, salvage values, and calculations that were approved for Consumers
11 Illinois Water Company, Northern Illinois Water Corporation, Illinois-American
12 Water Company, Lake Wildwood Water Company, and Del-Mar Water Company.

13
14 **Q. What is the effect on Apple Canyon Utility Company's depreciation expense**
15 **using the proposed depreciation rates?**

16 A. Depreciation expense of Apple Canyon Utility Company will increase by
17 approximately \$17,189 based on proposed depreciation rates. In addition, the
18 overall composite depreciation rates will raise from 1.55% to 2.99%. This increase
19 is consistent with prior rate proceedings approved by the Commission.

20
21 **Billing Cycles**

22
23 **Q. What is the current billing schedule for the customers of Apple Canyon Utility**
24 **Company?**

25 A. Apple Canyon's usage and availability customers are currently billed at the end of
26 each quarter.

27
28 **Q. What billing schedule is the Utility proposing?**

29 A. The Utility is proposing a change from a quarterly billing cycle to a monthly billing
30 cycle for Apple Canyon usage customers. The Utility believes that billing for
31 availability customers should remain on a quarterly cycle in order to avoid any
32 additional expenses.

1 **Q. Why is the Utility proposing a monthly billing cycle?**

2 A. The Utility believes that a monthly billing cycle will enable the Utility to provide
3 better service to the customers of Apple Canyon. First, a monthly billing cycle will
4 permit Apple Canyon customers to properly budget for water utility expenses each
5 month. Second, customer service representatives will be able to appropriately
6 address customer concerns as issues can be promptly detected. Third, the Utility
7 will be able to locate and resolve system problems as customer billing and
8 consumption data will be available monthly as opposed to quarterly.

9
10 **Q. Is this change in billing cycles consistent with the Utility's focus on providing
11 quality service to its customers?**

12 A. Yes, it is. The Utility believes that this change is beneficial to the customers and
13 the quality of their service.

14
15 **Q. What impact will this change in billing cycles have on operating expenses?**

16 A. The change to a monthly billing cycle will increase office expenses due to an
17 increase in postage, bank charges, and office stock, such as paper and envelopes,
18 which results from additional mailings and deposits made throughout the year. In
19 addition, there will be an increase in meter reading expense; however, no additional
20 employees are required to handle the increased number of billings.

21
22 **Rules, Regulations, and Conditions of Service Tariffs**

23
24 **Q. Does the Utility plan to update the Rules, Regulations, and Conditions of
25 Service tariffs for Apple Canyon Utility Company?**

26 A. Yes, it does.

27
28 **Q. Please explain why the Utility is proposing to update Apple Canyon's Rules,
29 Regulations, and Conditions of Service tariffs.**

30 A. The Utility has proposed to update its Rules, Regulations, and Conditions of
31 Service tariffs as they have not been updated in more than 12 years. Since this
32 time, Staff has compiled updated Rules, Regulations, and Conditions of Service
33 tariffs that have been provided to other Illinois regulated utilities, including
34 Utilities, Inc., Apple Canyon's parent company. Utilities, Inc. has filed updated
35 Rules, Regulations, and Conditions of Service tariffs for Docket No. 01-0050,

1 Westlake Utility, Inc. and has agreed to file these tariffs for Docket No. 02-0592,
2 Del-Mar Water Company.
3

4 **Filing Procedures**
5

6 **Q. Why is Apple Canyon Utility Company filing under the Standard Rate Case**
7 **Procedures instead of the Short Form Procedures that are in place for a**
8 **company the size of Apple Canyon Utility Company?**

9 A. Utilities, Inc. has determined that our short form filings are conducted in the same
10 manner as a general rate filing. This is because Utilities, Inc. has a staff of
11 accounting and ratemaking professionals. Additionally, under the short form
12 process there is no formal procedure for seeking a mediation of disputed
13 adjustments made by the Staff to the Utility's revenue requirement. This can be
14 unfair to the Utility.
15

16 **Q. Does this conclude your testimony?**

17 A. Yes it does.